

Message Text

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ACTION ARA-14

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C O N F I D E N T I A L LIMA 4742

E.O. 11652: GDS

TAGS: EFIN PE

SUBJ: FINANCIAL CRISIS; CENTRAL BANK PLANS

1. I SPENT ABOUT AN HOUR MAY 31 IN INFORMAL CONVERSATION WITH MANUEL MOREIRA AND ALONSO POLAR, RESPECTIVELY PRESIDENT AND GENERAL MANAGER OF THE CENTRAL BANK. OUR TALK WAS AT MOREIRA'S INVITATION AND FOLLOWED A BRIEF CEREMONY ATTENDANT ON THE SIGNING OF THE \$15 MILLION AID LOAN TO ESTABLISH A REDISCOUNT FACILITY IN THE CENTRAL BANK FOR THE FINANCING OF AGRO-INDUSTRIAL SUB-PROJECTS. FOLLOWING ARE THE KEY POINTS MOREIRA AND POLAR MADE IN DISCUSSING THEIR PLANS.

(A) THE CENTRAL BANK IS ABOUT TO CONCLUDE APPROXIMATELY \$80 MILLION IN SWAP AGREEMENTS THROUGH THE SPANISH BANKING SYSTEM. WITH SWAPS PROVIDED BY VENEZUELA, ARGENTINA, BRAZIL AND MEXICO, AND ASSUMING THE SUCCESS OF THE ROLLOVER NEGOTIATIONS WITH THE BANKS, PERU NOW HAS THE TIME TO PUT ITS FINANCES IN ORDER.

(B) MOREIRA HOPES FOR FAVORABLE WORD FROM THE STEERING COMMITTEE ON THE ROLLOVERS IN ABOUT THREE WEEKS. HE ALSO HOPES BY THEN TO BE READY FOR SERIOUS NEGOTIATIONS WITH THE IMF. THE OBJECTIVE IS A NEW STANDBY TO
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BE SIGNED IN SEPTEMBER WITH THE FIRST TRANCHE COMING AT THE END OF THE YEAR. A "PARIS CLUB" RESCHEDULING (BUT NOT NECESSARILY IN PARIS ACCORDING TO MOREIRA) WOULD FOLLOW THE SIGNING OF THE STANDBY.

(C) MOREIRA AND POLAR HAVE CONCLUDED THAT THE RESCHEDULING OF GOVERNMENT-TO-GOVERNMENT DEBT SHOULD BE

CONSIDERABLY MORE MODEST IN SCOPE THAN ORIGINALLY ENVISAGED, AIMED AT A SERVICING TARGET OF PERHAPS 40 PERCENT OF EXPORT RECEIPTS RATHER THAN THE 25 PERCENT THE PRESIDENT AND THE FOREIGN MINISTER HAVE BEEN TALKING ABOUT. POLAR NOTED THAT WITH THE MORE DRASTIC RESCHEDULING, INTEREST PAYMENTS WOULD "EAT US UP" AND PERU WOULD BE JUST AS DEEP IN THE HOLE IN THE EARLY 80'S AS IT IS NOW.

(D) MOREIRA ANTICIPATED THAT THE PRIMARY ISSUE IN THE NEGOTIATIONS WITH THE FUND WILL BE THE EXCHANGE RATE. THE CENTRAL BANK MOVED THE RATE UP SLIGHTLY (TO 151) ON MAY 30 AND WILL CONTINUE THAT GRADUALIST APPROACH. ASSUMING AN INFLATION RATE OF 60 PERCENT ON AN ANNUAL BASIS IN THE SECOND HALF OF 1978, MOREIRA AND POLAR LOOK FOR AN EXCHANGE RATE OF ABOUT 180 AT THE END OF THE YEAR. ALTHOUGH THEY DISLIKE THE TWO-TIER SYSTEM RESULTING FROM THE CERTIFICATES MARKET, THEY PLAN TO LEAVE THE LATTER ENTIRELY ALONE TO FUNCTION AS A FUTURES MARKET. AS CONFIDENCE IS RESTORED AND SOME PREDICTABILITY IN EXCHANGE-RATE MOVEMENTS REGAINED, THE SPREAD BETWEEN THE TWO RATES SHOULD SHRINK. ABOUT 20 POINTS AT THE END OF THE YEAR WOULD SEEM REASONABLE IF THE CENTRAL BANK'S PROJECTIONS ARE CORRECT. WE NOTED THAT THE CD RATE HAS ALREADY DECLINED SLIGHTLY, DOWN TO 201. MOREIRA OBSERVED THAT UNDER PERUVIAN LAW AND THE STATUTES OF CONFIDENTIAL

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HIS INSTITUTION THE EXCHANGE RATE IS THE EXCLUSIVE RESPONSIBILITY OF THE CENTRAL BANK, AN AUTHORITY HIS PREDECESSORS SEEM TO HAVE FORGOTTEN BUT WHICH HE IS NOW EXERCISING.

(E) THE BANK'S NEW TEAM AGREES THAT THE COUNTRY'S ECONOMIC HEALTH REQUIRES POSITIVE INTERNAL INTEREST RATES. AGAIN, THE BANK WILL MOVE GRADUALLY AND BY STAGES IN THAT DIRECTION.

2. MOREIRA EMPHASIZED THROUGHOUT THAT NEW "EARTHQUAKES" MUST BE AVOIDED. THIS THE IMPORTANCE OF THE GRADUALIST APPROACH. HE AND POLAR ALSO STRESSED THAT THE CRITICAL PROBLEM IS THE POLITICAL SITUATION. THEY THOUGHT JAVIER SILVA WOULD PROVE A MORE COURAGEOUS FINANCE MINISTER THAN BARUA WHO WAS THEIR CHIEF WHEN THEY WERE LAST IN GOVERNMENT AND WHO PROVED INCAPABLE OF STANDING UP TO THE MILITARY WHEN IT COUNTED. BUT THE DUBIOUS PROSPECTS FOR ELECTIONS AND THE CONTINUING GENERAL UNCERTAINTY ABOUT WHERE THE COUNTRY IS GOING POLITICALLY WILL MAKE IT DIFFICULT TO MANAGE THE FINANCIAL PROGRAMS UNDER THE BEST OF CIRCUMSTANCES.

3. COMMENT: MOREIRA AND POLAR ARE BRIGHT, ARTICULATE,
AND SELF-CONFIDENT YOUNG MEN -- SO DIFFERENT FROM THEIR
HANGDOG PREDECESSORS. BUT THEIR CHANCES FOR SUCCESS
DO INDEED DEPEND TO A CONSIDERABLE DEGREE ON HOW THE
POLITICAL SITUATION EVOLVES.
SHLAUDEMAM

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